

Marginalizing the Masses

Noam Chomsky

*Professor of Linguistics and Philosophy
Massachusetts Institute of Technology*

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by Robert A. Schupp and Richard L. Ohlemacher
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JOURNAL: The *Journal* has approached this particular publication on Shadow Economies in an effort to explore the socioeconomic aspects of the subject. General themes have emerged that reveal instances of economic imbalances stemming from political, legislative and commercial action that enriches some and impoverishes others. These implications of shadow economies, which is in many cases a marginalization of the masses, relate to much of your work on the politics of power and justice among nations and people.

MR. CHOMSKY: In everything I have read about it, there are properties that are rather common in discussing this topic. Whether we are discussing terrorism or crime or anything else, there is a strong tendency in the literature to focus on what you might call the retail rather than the wholesale aspects. In the case of criminal activities, for example, on terrorist activities of the weak rather than terrorist activities of the strong. And I think that the same is true in discussion of the shadow economy.

There are overwhelming elements of non-informal economies that are not discussed much. Tax havens for example, are probably a substantial element of the international economy. But these elements of "informal economies" are part of the world of the strong and privileged, so not very much is known about them. They are not the focus of a great deal of attention and investigation, like drugs. In fact there are major factors in the drug system that are much too little discussed, such as the reasons why peasant

farmers turn to coca production. They are being driven to it by the very policies that the powerful states advocate. For example, if you try to drive peasants to agro-export and you undercut the conditions for production for local markets by massive imports, and also establish conditions under which export of major commodities undergoes sharp price fluctuations, then peasants will not have many choices. They are likely to turn to production of commodities for which there is always demand. And that has happened. Colombia is a good case. Colombia had, and has, possibilities for non-drug agricultural production, but they have very substantially been undercut by external intervention. One of the more important cases involves efforts to stabilize commodity prices. For large-scale agribusiness it is not all that important if prices oscillate. But if you are a small peasant farmer, you cannot say, "I am not going to feed my children next year because the price is too low." Prices have to be stable if you want to be a small coffee producer.

There were Third World efforts to introduce commodity stabilization, but they were simply undercut by the rich countries. The United Nations Conference on Trade and Development (UNCTAD), in a core part of what was called "the new international economic order" back in the early 1970s, tried in one of its first major efforts to introduce measures to stabilize commodity prices. This would be analogous on an international scale to the ways every rich country stabilizes agricultural prices internally—by market interventions. The rich countries would not allow it—primarily the United States. That drives peasants away from coffee production.

Take Food for Peace Aid. In Colombia back in the 1950s, it sounded like a nice idea, except that it undercut domestic wheat production. So that eliminates another possibility. Once various possibilities are cut away and massive state terror is introduced—which happened, in no small measure from US initiatives to prevent efforts to ameliorate deplorable socioeconomic conditions—you end up with the drug culture. Those are massive factors in drug production, but they are not the ones that are being addressed in policy or much discussed, outside of specialist literature. The current drug war is not aimed at stabilizing commodity prices for coffee production, just to take one example of many. In fact even support for alternative crops is a very marginal aspect. Judging by the programs that are now on the agenda, the real motives can

hardly be the professed ones, for many reasons.

JOURNAL: How does the consumer and corporate power of wealthy nations contribute to shadow economies around the globe?

MR. CHOMSKY: What I just mentioned was a case in point. That is not consumer power, it is corporate power. When the United States and other rich countries undermine the efforts by the G77 group of countries to work through UNCTAD to develop commodity stabilization programs, which would allow small peasant production, that is corporate power having a huge effect on shadow economies. But it is also much bigger than that.

Take tax havens again. Nobody knows the scale of their use because it has not been studied much, but chances are that tax havens are a major factor in the international economy; probably well beyond drug money laundering, as pointed out by political economist Susan Strange in her most recent book.

In fact, even the gross statistics, which as far as I know have not been much investigated, reveal what appear to be significant effects of these devices. The Commerce Department publishes detailed quarterly reports on Foreign Direct Investment (FDI). Out of curiosity, I was reading them regularly during the recent period of enthusiasm about "new emerging markets" in Latin America. For the Western Hemisphere (excluding Canada), roughly 25 percent of FDI was regularly going to Bermuda, maybe 10 or 15 percent to the British Caribbean Islands and roughly 10 percent to Panama. This reflects one aspect of corporate power: about half of FDI was going to what a benign view might consider as tax havens. The less benign view would be that the category of FDI covers methods for laundering criminal money—drug money or something else. But it is certainly not building steel mills. They do not do that in Bermuda or the Cayman Islands.

Fifty percent is not a small number. That is a big part of the economy. During this period of enthusiasm about emerging Latin American markets and the importance of FDI, I did not find a single paper in the professional literature that even talked about these points (although they were discussed by Doug Henwood in his invaluable journal, *Left Business Observer*). Perhaps there were papers—I do not know the technical literature that well—but I could not find them. Certainly there must be specialists who know a lot about it, but compared with the problems of the shadow

economy that are discussed, this one seems substantial.

So, that appears to be a case in which corporate activities are having a significant effect on the international economy, within “shadow economies”—violating the rules. Of course, wherever this money is, it is redistributing wealth, income and power upward, toward the richest sectors, apart from the effects it has everywhere else. The World Trade Organization recently ruled against the United States for permitting corporate use of what amount to tax havens as a technique of export subsidy. That apparently is a small fraction of this behavior on a global scale.

JOURNAL: Is the shadow economy today the same as it has always been? Or, is it taking on new characteristics and evolving with globalization?

MR. CHOMSKY: Globalization is a phenomenon that is new in some respects but quite old in others. As many have pointed out, by gross measures the global economy is not much different from what it was before the First World War. Upon closer look, however, there are important differences. For example, the scale of speculative financial flows and short-term financial flows, is astronomically beyond anything it has ever been before. The distribution of production around the world, mostly administered by multinational enterprises, is also sharply different.

I think Barry Eichengreen pointed out one of the most striking differences. He was not really talking about this, but there are implications about it in his history of modern financial systems. He pointed out that in the late 19th century, economic decision-making had not yet been “politicized” by the rise of parliamentary labor parties, unions and universal male suffrage. The general public could be more or less excluded from decision-making. As a result, the costs of financial rectitude—keeping currencies stable and so on—could be simply imposed on the population. It was possible to have a situation where there would be no special constraints on capital flow and yet, still have a relatively stable economy.

By the 1940s, things had changed. There were unions, parliamentary labor parties and, in principle, large-scale suffrage. In order to compensate for this “politicization” of decision making—meaning the public has a voice—it was necessary to institute capital controls and relatively fixed exchange rates. The luxury of imposing the costs on a defenseless public was no longer

available, as it still is in the Third World through structural adjustment programs and other devices. The Bretton Woods system instituted regulated currencies and the option of capital controls to compensate for the inability to impose the costs on the population, as before.

There is a corollary relating to what is now called “globalization.” Since the mid 1970s, we have seen a system in which exchange rates float and limitations on capital flow have eroded. Following the same reasoning as before, we would expect a significant impact on popular sovereignty, on the ability of people to participate in economic decision-making through government economic management and social policies. These are options that erode under the threat of capital flight and attacks on currencies—under the “veto power” of the “virtual parliament,” as the process is sometimes called. That has happened, noticeably. There also has been a slow-down in growth and deterioration of other macroeconomic indicators. This is called “globalization,” but it is a particular form of integration of international society.

The particular form of globalization that has been imposed has specific consequences. It is not a matter of simply increasing interactions among countries; rather, of doing so in a particular fashion that happens to be geared to rights of investors and lenders, and concentrated private power generally, supported by the most powerful states and the international bureaucracies they have established. These are particular modes of “globalization” that are, in basic respects, incompatible with popular sovereignty in socioeconomic decision making and with social programs concerned for the welfare of the general population; not maximization of profit and market control. Popular sovereignty is undercut by the focus on maximization of profit and control and financial liberalization that is a core element of contemporary “globalization.”

The same is true of the distribution of production, which enables a lot of so-called trade really to be interactions that are internally or centrally managed within a basically totalitarian structure. We call it trade, but certainly a large proportion of it is centrally managed. It is not trade in any serious sense. I think economist Jeffrey Sachs is on target in calling these facts about cross-border flows “stunning.”

A common estimate—it is really a guess, since there is little careful investigation—is that roughly 40 percent of cross-border transfers are intra-firm, and that leaves out a significant amount.

Outsourcing, for example, is in essence centrally managed. And if we were to count in the effects of strategic alliances we would find that, according to some estimates, 70 percent of world trade is in substantial degree centrally managed. That is a particular form of administration of markets by highly centralized systems that have various strategic alliances with one another and rely very heavily on powerful states to socialize cost and risk. It is one kind of globalization, with specific effects. But you cannot call that in itself “globalization;” it is one particular form of the design of international integration in the interests of corporate power. It tends to marginalize large numbers of people, which tends to lead to what are called shadow or informal economies. These terms are used for people bartering without paying taxes, but not for the massive use of tax havens to shift the burden to the general population and away from the rich, along with all of the other effects that it has on economies. I think that one has to be careful about these terms.

JOURNAL: Frequently, terms having negative connotations are used in reference to informal economic activity—words such as shadow, gray, underground and black market. Do you feel that these are appropriate for understanding the dynamics of informal economies?

MR. CHOMSKY: Yes, if you want to understand them, sure. Every social system, whether it is a family or an international economy, has some kind of norms. If it is an organized system, like states, the norms turn out to be enforceable rules. Sometimes they are backed by state force, or other forms such as Mafia force. If we consider the rules that are more or less codified in the state and interstate systems, economic behavior that does not conform to those rules could be called a “shadow economy.” The major component of that is activities such as tax evasion on the part of major corporations or money laundering, and so on. But since these are the prerogative of the powerful, they are not what are usually meant in discussion of “shadow economy.”

There are other aspects of interactions that violate rules and norms, which are carried out by the poor. That is what is commonly called the “shadow economy.” But if we are to be clear about it, they are all violations of the norms and rules, and those norms

and rules themselves are designed in the interests of the powerful.

I think it is a good analytic tool, but we should use it without bias; that is, without a bias that leans away from the rich and powerful and towards the poor and defenseless. Which is not only true here; as I mentioned, it is true in other domains too. Take crime. Every criminologist knows that corporate crime—white-collar crime—is enormous in scale, and well beyond street crime in scale and effects. Since nobody really studies it in close detail, we do not have reliable numbers, but probably in orders of magnitude the numbers that are given in many criminology texts are more or less accurate. According to some estimates, property crime carried out by corporations is maybe on the order of five-hundred-times as high as street property crimes. It is hard to count killings because we do not know how many of the worker-related deaths to attribute to willful negligence or violations of Occupational Safety and Health Administration (OSHA) regulations, but the numbers are surely high. It probably overwhelms the number of street killings.

The US is roughly similar to other industrial societies in level of crime, but it is quite different in terms of fear of crime and punishment of crime. That has been dramatically so since the onset of “globalization.” The US is, by now, off the spectrum in both of those respects. If we look at punishment, we find that it is not directed at those who are involved in major crime, but at those who carry out retail crime. In fact by now many of them are not involved in crime at all, except by newly-devised standards that criminalize certain victimless activities—typically those carried out by the poor, the “dangerous classes” as they have been called.

The whole culture, the political and social culture of fear of crime, and harsh punishment of crime—both unusually high by comparative standards during the “globalization” era—focuses on the weak and defenseless, not on the rich and powerful, who are responsible for most of it.

I think we see a similar phenomenon when we talk about the shadow economy. It is not that the topics discussed are not important, they are. If we take a country like India, rough estimates are that the black economy may be one-and-a-half times the size of the formal economy, maybe more, so it is not small. On the other hand, what is called the black economy very often is not considering the fact that a multinational corporation has its corporate base in the Caribbean islands or Mauritius.

JOURNAL: The shadow economy is generally viewed as a problem in that informal economic activities compete with legal entities, and often deprive the state of funds that could be used to strengthen the structure of society. Hernando De Soto, in *The Other Path*, asserts that for Peru this kind of thinking is erroneous, that the state itself marginalizes people toward informal economic endeavors. How do you see the dynamics between the informal and formal economy depriving the state of funds?

MR. CHOMSKY: Tax evasion by major corporations is a major phenomenon. I do not think it has really been studied to the point that one can put numbers on it. But, for example Susan Strange concludes that it is one of the dominant forces in the international economy. That is only one component of wholesale “shadow economy” that escapes the rules. If we look at money laundering, that is also huge, including the drug business. The “shadow” arms trade, the illegal immigrant trade, the trade in coerced sex—these are undoubtedly very large parts of the international economy. De Soto is talking about a real problem. In a state like Peru, it is true that people are marginalized and driven to other kinds of activity in order to survive and function. You do not have to look very far to find it. We can find it right here. On the other hand, if you look at the rules themselves, they also are designed to marginalize people. Again, you don’t have to go very far. Take the building where we are right now. I have been working here at MIT for 45 years and I think this is a great place, which is why I have never thought of leaving. But we should not overlook the fact that the institution is part of a larger system, by which the public is compelled to bear the costs and risks of economic development so that the profits can be privatized. So, a good part of the economy relies on devices to ensure that cost and risk are socialized, and profit is privatized. And this institution is just one part of the funnel through which that happens.

Is the public marginalized in this system? Hopelessly marginalized. Consider the Internet. Was the public aware that for 30 years they were paying for the cost of developing it, bearing the risks of failure and that the government decided in 1995 to give it as a gift to some big corporations? I do not think that much of the public is aware of that. Even to find out how the decision was made to transfer this enormous public creation into private pockets is no small task. According to the technical

literature, the matter is still quite obscure. Does all of this mean the American public was marginalized? Sure, very much so. And you can say the same about just about every other dynamic aspect of the economy.

So yes, there is tremendous marginalization, but that is within the rules, not outside the rules.

JOURNAL: It has been alleged that in India, the shadow economy is roughly one-and-a-half-times the size of the formal economy. If the economic activity that is taking place within that shadow economy could be brought into state structures, do you think that it would be used to strengthen Indian society?

MR. CHOMSKY: Well, that depends on how Indian society is organized. I mean the reason for the black economy is because opportunities are lacking within the formal rule-governed structures. If people could participate constructively within the organized economy they would do so. The kind of shadow economy you are talking about—where people engage in barter interactions or whatever it may be—those are activities that people are driven to because they do not have opportunities.

JOURNAL: In some developed countries it is thought that the size of the shadow economy is between 18 to 25 percent of economic activity. In Scandinavia, where most people are able to participate, perhaps this could be described as a thriving shadow economy.

MR. CHOMSKY: Well you have to disaggregate and determine what types of activities they are undertaking. I suspect that if you looked at the informal economy in, say, Sweden, you would find much larger numbers than that. You would have to ask questions (to which I do not know the answers) such as how Ericsson evades their tax responsibilities. I would guess that they do, if they are like other corporations, and if they do then that is part of the black economy. I do not know much about Sweden but I suspect that those numbers would be quite large.

There are other numbers that you could look at within the rules. Ericsson, which is a big multinational, makes large profits on things like mobile phone technology, which is an offshoot of the Swedish military system, much like a good part of the economy here. They

have a military system that is highly advanced for a small country—with high-tech aircraft, for example—and that is, of course, publicly funded. One domestic function of high-tech military systems is to provide a cover for high technology development, at public cost and risk, culminating with Ericsson deriving substantial profits on mobile phones. That is a cost that the public did not decide to bear any more than people here decided to use their money to develop computers. They did not decide it. They did not know about it, and most still do not know about it. Furthermore, they do not know that their taxes are now being used for nanotechnology tomorrow either. These are operations within the rules, forms of socialization of risk and cost. Maybe they are good decisions in terms of long-run welfare benefits, maybe not. But the public is marginalized. It is not involved in these decisions, and knows little about them. If people did know, and had substantive democratic modes of participation, they might well decide to use the wealth that they produce in quite different ways.

And if Ericsson proceeds, as it well may, to shift production to low-cost areas, and away from Sweden, where the people paid for the wealth of this company, that is another way of marginalizing the public. If it uses tax havens, or tax write-offs, or if it forces the government into granting it subsidies in order to stay there, these are other ways in which a private power system can marginalize the public.

Suppose you added up all these numbers, which nobody does. I suspect you would find that this covers a substantial proportion of the global economy. Consider the state of Massachusetts, where we are. The major services corporation in Massachusetts is Fidelity, and the major industrial producer is Raytheon. These are called private enterprises, although I think that use of the term “private” is a bit of a word-game. A couple of years ago they both demanded that the state provide them with what amounts to a subsidy in tax reductions or they would move. Fidelity would move to Rhode Island, and Raytheon would move to Tennessee, for example. The state therefore granted them big subsidies through tax changes. Should they have the right to demand that? Why should a system of private power—unaccountable private power—have the right to compel the population that essentially created them to grant them further subsidies? Raytheon made a deal, on the understanding that they would keep some of their work force local. They later reneged on the deal (so it is reported). But the very

existence of those relations is a way of marginalizing the public; that is, subordinating it to unaccountable private power. And that is again within the rules, not outside the rules.

It seems to me that if we want to study this topic seriously we should look at it from a different perspective. To what extent does the formation of the rules and the observance of the rules relate to actual participation of people in determining their own fate? Under what we should call democracy and freedom? It is certainly true that the shadow economy in Sweden is drawing funds away from the public, but it is presumably a small portion of the total picture, if we shift to (what seems to me) a more realistic perspective.

JOURNAL: In terms of governance, then, what types of appropriate policy options would be in the best interest of both developing and developed nations?

MR. CHOMSKY: That ranges from technical questions to very broad questions. For example, returning to the earlier example of G77/UNCTAD, measures for stabilization of commodity prices might well have been of significant benefit to small farmers in much of the world, and also to global society—for example, by undercutting a lot of the basis for the drug trade, which encompasses many criminal activities and leads to the destruction of lives (among other things). Something as simple as stabilizing commodity prices would have had an effect, probably a major effect, for many people. These are things that are possible, and they are not outlandish. Every major society like the US or the EU does it internally, but they would not allow it to be done in the interest of the poor in the South.

That raises other questions: What right does a private company have to make decisions on its own? On what grounds does a state-chartered corporation have the right to demand not only personal rights, but rights that are way beyond any person?

If we go back a century, we can find that various “organic structures,” as they were sometimes called, were being developed and accorded rights over and above people. Something like that had been true under feudal systems, but now we had new ones.

There were basically three kinds gaining prominence in the early 20th century: one was Fascism, a second was Bolshevism, and a third was private corporations—corporatism. They were similar,

in that they demanded and received—more or less by force—rights that are independent of the rights of people. They had their own rights, as entities. In the United States it was done mostly by radical judicial activism. Two of the systems have collapsed, the third remains, more powerful than ever.

We should, however, question the justification for what amounts to unaccountable private tyranny. It is a real question, though one that is far-reaching, as distinct from stabilizing commodity prices, or imposing some kind of constraints on free capital flow, which is probably very harmful to the economy, as well as to substantive democracy.

JOURNAL: Do you see how commercial interests might also influence solutions to the problems that exist in shadow economies?

MR. CHOMSKY: Can the problems of shadow economies be dealt with within commercial institutions, like firms for example? Yes, a firm can decide not to use tax loopholes. Or Microsoft, for example, could decide not to take the public gift of the Internet. I do not expect any of these things to happen, but yes, it could happen. It will most likely not happen because the institutional structure of firms does not allow it. Here, I think that Thomas Friedman is correct. There is an obligation on the part of the board of directors to act in a way that is highly anti-social, namely, to maximize profit and market share. That is their legal obligation. The rules are designed so that these anti-social activities are required on the part of major institutions. That is a problem with the rules. And in order to move towards a more free and just society, the rules should be changed.

JOURNAL: It could be said that the reality of informal economic activities is, in a sense, Capitalism in its purest form: the maximization of profits and risk-taking without regulation. Which would you say is the anomaly? The formal or the informal economy?

MR. CHOMSKY: I think the informal economies are more like the model of capitalism than the formal economies. The informal economies are more like what Adam Smith would have called a market. In contrast, the formal economy—the international

economy—is a kind of mercantilism, or corporate mercantilism, with administered markets and administered interactions, much of it involving interactions among alleged competitors. For example, IBM, Toshiba and Siemens might work together on some development project, while they are all supported (in not such complicated ways) by socialization of risk and cost. That has little resemblance to anything an advocate of free markets would support. And these are not small proportions. The numbers we are mentioning, such as the percentage of central administration of cross-border interactions—which we call “trade”—these are undoubtedly large numbers. Similarly, techniques of tax evasion and laundering—what probably lies behind the FDI figures I mentioned before—have not been very closely investigated, as far as I know.

In contrast, an informal economy in some country in Africa, where one finds many people living in an informal economy that has trading occurring in a local market, that probably looks more like a capitalist society.

JOURNAL: One aspect that has consistently emerged during the *Journal's* research for this issue is that the informal economy is poorly understood, or practically invisible. Why do you think that is so? Is it because a lot of this activity is considered illicit, nefarious activity? Is it because of pressure by vested interests? Or, is it attributable to the difficulty of accurately measuring the size of the informal economy?

MR. CHOMSKY: Well, it certainly is technically difficult. It is harder to measure things that are not registered and listed in the bookkeeping. That is going to be harder to measure. On the other hand—again, I always come back to the same point—the major elements of the non-rule based economy, or the informal economy, are not studied because they involve interests that are simply too powerful. We do not find investigation of such substantial matters as the scale of resort to tax havens. Even the proportion of international trade that is intra-firm—that is something that could be identified, but if one were to try it would be extremely difficult. As mentioned earlier, there was an international monitoring system at the UN, but that was undercut because the rich societies did not want it.

What proportion of cross-border transactions are really centrally

managed? That is something that one could conceivably ascertain, bringing into account intra-firm trade, outsourcing, strategic alliances and other devices. But, powerful interests would prefer that not to happen, and the analyses that exist are substantially based on guesses. I have sometimes tried to check some of them through footnotes, only to find that they trace back to what are really guesses.

Many important matters are not studied carefully. Consider something as fundamental as social indicators: child abuse, health, hunger, illiteracy and so on. Most countries, and just about every industrial country, at least take a stab at it. Even the government of Turkey publishes reports on social indicators. The United States does not. If you want to figure out the relation between class and mortality or something like that, or what the shifts are in social indicators over the years, you have to go to private investigators. Fordham University has an institute that has tried to monitor social indicators. It is not a government project. In fact, at least as of a few years ago, probably still today, the Census Bureau did not even give data on class-related factors. You can find out about race and mortality, but when Johns Hopkins University public health specialist Vicente Navarro wanted to find out something about class and mortality, he had to do complicated computations based on other correlations that are given.

These are not topics that are intended to be studied, and for strong reasons. If you look, for example, at the efforts of the Fordham University project to monitor social health, they are not on the scale of a major government project, so one has to take the numbers with a grain of salt, though the tendencies are probably correct.

One of the basic things that they have discovered—and it shows up in a lot of other parts of the social and economic system as well—is that through the early post-war period (which some people call the golden age of state capitalism, roughly 1950 to the mid 1970s) social indicators tended to rise along with GDP. Later, the measures diverged: GDP continues to increase, although not as fast as previously and social indicators actually decline. It is difficult to overlook the fact that this was the period of the breakdown of the Bretton-Woods system, that is, of capital controls and regulated currencies, the period of “globalization” in the contemporary sense. The Bretton Woods system was instituted in part because it was expected that free capital flow and fluctuating currencies would undercut the possibilities for national socioeconomic management,

or, democratic participation in deciding socioeconomic planning. That was why Keynes, White and others instituted those conditions, quite explicitly. With the breakdown of conditions you get the expected effects. That is not a major topic in the mainstream. It is well studied, but it does not really enter the public arena. Many things are not studied, or remain out of general view, because they cut too close to the center of power.

JOURNAL: As a final comment, would you be able to give us some thoughts on how civil society might find solutions to the problems of the shadow economy?

MR. CHOMSKY: Civil society ought to aim at empowerment, and democratization, that is, expanding to the limits the capacity of the people to participate in making the decisions that affect their own lives, their communities and the world. That is the task for civil society. For the last 200 years there have been popular struggles aiming at that and achieving quite a lot. And that is an ongoing task. I do not know how many problems can really be solved—life is a complicated affair—but whatever problems can be constructively solved should, and can be, dealt with in that fashion.

That requires dismantling unaccountable private power systems and unaccountable state power systems. It would require destroying totalitarian states and their counterpart in the socioeconomic system. That is the task for civil society—for societies and their members. ♣